BRIEF IN SUPPORT OF PETITION.

1. The Decision of the Circuit Court Herein Is in Conflict With the Decisions of the Tax Court of the United States and the Decision of the Circuit Court of Appeals for the Fifth Circuit in Scofield, Collector of Internal Revenue v. Valley Pipe Line Company, 138 Fed. (2d) 835.

Section 14 of the Revenue Act of 1936, c. 690, 49 Stat. 1648, contained a provision for the levy of a surtax on the undistributed profits of a corporation. The term "undistributed net income" was further defined to mean such income less the credit provided in Section 26(c) relating to contracts restricting dividends. Subsections (c)(2) of Section 26 provides that where a written contract has been executed by the corporation prior to May 1, 1936 expressly dealing with and requiring the application of earnings and profits of the taxable year to be paid within the taxable year in discharge of a debt, that a payment pursuant to such a written contract will be allowed as a credit and serve to reduce the surtax on undistributed profits.

In the case of *Scofield, Collector of Internal Revenue v. Valley Pipe Line Company*, 138 Fed. (2d) 835, the taxpayer, in filing its income tax return for the year 1936, claimed an undistributed profits surtax credit of sums paid in the year under a contract restricting payments of dividends. The contract in question called for the payment on the 20th of each month of 75% of the gross income of the taxpayer for the preceding month toward the maturity

of its indebtedness. The Collector of Internal Revenue asked for a reversal of the District Court decision because the contract, instead of providing as to the required payments in the words of the Statute that the payments are to be made out of "the earnings and profits" of the taxable year, merely provides for payment out of the "gross income". The Collector urged that a provision for payment out of gross income is not the equivalent of a provision for the payment out of "earnings and profits" because payment out of "gross income" could be made even if there were no earnings and profits. The Court, in rejecting the contention of the Collector, stated at page 837:

> "As applied to this case, the argument is purely hypothesis. The facts undisputed and found here are that included in gross income for the year in question were earnings and profits considerably in excess of the credit allowed and that the parties in contracting understood that there would be. Realizing that this is so, the collector, citing in support Treasury Regulations 94, Art. 26-2(c), takes the flat position that unless the provision for payment is such that it cannot be satisfied except out of net income, it is insufficient and, though it was intended that they should be, the payments were in fact, made out of net income, since the provision did not designate this as the sole source, it is not effective as a basis for credit. We do not at all agree either that the regulation means what the collector claims that it does or that it would be valid if it did have that meaning. While it is true that it draws a distinction between 'net'

and 'gross' income, the regulation deals not with a provision, as here, for payment of a certain percentage of the gross income, but of an amount 'equal to' that percentage, and thus accords with the uniform current of authority. If it should be construed as having the effect of writing the word 'net' into the Statute before the words 'earnings' and 'profits,' it would amount not to a construction but to rewriting of the Statute, and this the Commissioner may not by regulation do. Gross income of necessity includes whatever earnings and profits there are. This view has been uniformly taken by the Board in cases cited below,[1] and all of these decisions have been acquiesced in by the Commissioner."

In the case at bar the Circuit Court of Appeals for the Ninth Circuit, after considering the decisions of the Tax Court of the United States, which were referred to and followed by the Circuit Court of Appeals for the Fifth Circuit in *Scofield v. Valley Pipe Line Company, supra,* expresses its disagreement and refused to follow the decisions of the Tax Court, even though most of the decisions had been acquiesced in by the Commissioner of Internal Revenue.

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[1]*G. B. R. Oil Corp. v. Commissioner,* 40 B. T. A. 738; *Joell Co. v. Commissioner,* 41 B. T. A. 825; *Brockway Glass Co. v. Commissioner,* 43 B. T. A. 267; *Baltimore Steam Packet Co. v. Commissioner,* 44 B. T. A. 629; *Helvering v. Northwest Steel Rolling Mills, Inc.,* 311 U. S. 46, 61 S. Ct. 109, 85 L. Ed. 29; *N. O. Nelson Co. v. Commissioner,* 45 B. T. A. 899; *Carolina-Florida Realty Co. v. Commissioner,* 46 B. T. A. 777, 778; *Paris & Mt. Pleasant R. Co. v. Commissioner,* 47 B. T. A. 439.

The Circuit Court of Appeals for the Ninth Circuit, in the case at bar, stated the following with respect to the decision of the Circuit Court of Appeals for the Fifth Circuit in *Scofield v. Valley Pipe Line Company, supra:*

> "That decision, page 837, makes the bald statement that to treat the term as net earnings and profits and not gross earnings and profits is not the Statute's 'construction but . . . a rewriting of the Statute, and this the Commissioner may not by regulation do.' For the reasons indicated we do not agree."

Petitioner respectfully submits that the decision and opinion below constitutes a direct conflict with the decision and opinion of the Circuit Court of Appeals for the Fifth Circuit which should be settled by this Court.

2. The Circuit Court of Appeals Has Decided an Important Question of Federal Tax Law Which Has Not Been but Should Be Settled by This Court.

This Court has taken occasion to consider the provisions of Section 26(c)(2) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, in the three cases of *Helvering v. Ohio Leather Company, Helvering v. Strong Manufacturing Company,* and *Helvering v. Warren Tool Company,* 317 U. S. 102. This Court has also considered the effect of a State Charter as constituting a contract restricting the payments of dividends in *Helvering v. Northwest Steel Rolling Mills, Inc.,* 311 U. S. 46.

The precise question here at issue concerning the meaning of the terms "earnings and profits of the taxable year", as used in Section 26(c)(2) of the Revenue Act of 1936, has never been considered by this Court, and the proper construction of the same is an important question of Federal law which has not been, but should be, settled by this Court.

Counsel for petitioner certifies that in their opinion this petition is well founded and is not interposed for delay.

It is respectfully submitted that this petition should be granted.

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